1812

THE NATIONAL CITY BANK OF NEW YORK
EST. 1812

1953

Monthly Letter on Economic Conditions Government Finance

New York, September, 1953

General Business Conditions

THE month of August has rounded out a summer which, in volume of production and trade, has probably exceeded any previous summer. Industrial production, after a dip in July due mainly to vacations, recovered in August to near the high levels of the spring. Employment overall has continued to tax the available labor supply. Aggregate retail distribution apparently equalled or exceeded last year's figures.

At the same time, supplies in some durable goods lines have become easier under the impact of such high production. Consequently buyers, feeling more assured of being able to satisfy their requirements, are tending to shorten their forward commitments. The steel industry, after setting a new output record of 67,230,000 tons in the first seven months, has recently been operating under less pressure. While some steel products continue scarce, others are reported to be freely available. Steel production eased off to about 95 per cent of capacity during the summer, due partly to seasonal factors, need for furnace repairs, etc. With the less insistent demand, operations have remained around that level, and the presidents of two large steel companies voice the expectation of a further dip during the fourth quarter.

Similar easing is found in other durable goods lines. Farm machinery makers have cut back production as the decline in farm incomes has been reflected in lower farm implement sales. In the home appliance fields, production of air conditioners, driers, and television sets continues active, whereas several other items are lagging. The machine tool industry has been working down its backlog, as new defense orders have been fewer. In the lumber industry activity is somewhat lower than last year, but new orders are in line with current production. In general, the durable goods industries appear to face some moderation of the hectic pace at which they have been going since Korea.

The nondurable goods manufacturers, which as a group did not experience as great an expansion in production, continue, with few exceptions, to make a good showing. Paperboard production demonstrated renewed strength after a vacation let-down, and the price was advanced $5 a ton. Paperboard serves as a good indicator of short-term business activity because it reflects the quantity of shipping containers required to package an almost countless variety of finished manufactured goods. Production, new orders, and unfilled orders for paperboard are considerably higher than a year ago. Similarly sulphuric acid and alcohol, key chemicals widely used as industrial materials, are being produced at capacity. In the textile industry many cotton mills have booked orders well into the first quarter of 1954.

CONTENTS

High Personal Incomes and Retail Sales

The strength in nondurable goods production reflects the sustained high level of employment and personal incomes. Employment holds around a record high of 63,000,000 with unemployment near rock-bottom. Most of the net addition of workers this summer was in agriculture, but non-farm employment showed less than its usual seasonal dip.

Full employment and a continued advance in average hourly earnings have carried the total of personal incomes to a new peak in spite of the lag in farm income. Consumers remain well disposed to spend their income, as indicated by figures on automobile sales and sales by department stores and other retail outlets throughout the country.

Retail deliveries of both new and used cars in early August were at the same high level as in July. Figures reported by new car dealers show that stocks of both new and used cars held by such dealers have increased this summer but still approximate only one month's sales. Figures on stocks held by dealers in used cars are unfortunately not available.Used car prices relative to new car prices continue to decline, though still remaining above pre-World War II relationships. Passenger car output in August was almost as high as in July, despite a cutback by some of the smaller producers and the fire at a General Motors transmission plant.

Department store sales across the nation in August failed to show as good gains as in earlier months of the year, but were nevertheless even with those a year ago. The figures by Federal Reserve districts indicate the best showing was in industrial areas.

July retail sales of all outlets, including automobile dealers, gasoline stations, chain stores, etc., made a better showing than those of the department stores alone, with a gain for the month of 6 per cent over a year ago – the same as shown for the first seven months. The gain over last year was largely accounted for by durable goods such as automobiles, refrigerators, and other appliances.

Consumers are still buying on credit, but apparently the volume of new instalment credit extended has not been increasing. According to figures published through June, the volume of new business written peaked in March, declining moderately in succeeding months. Nevertheless, since new loans made exceeded monthly repayments, the reported total outstandings continued to rise to a new high at the end of July.

Construction and General Activity

An encouraging feature of the business news is the favorable showing of the latest building construction figures. New contract awards, as compiled by F. W. Dodge Corporation, showed for July and the first fifteen days of August gains of 14 per cent and 3 per cent respectively over the same periods a year ago. This showing is the more noteworthy in that it is a reversal of the softening that had seemed to be indicated by the figures for the latter part of May and for June.

Contributing to the July rise in the building figures were the highest monthly awards for commercial building and for educational and science building in the history of the Dodge series. Even the residential classification, which had shown weakness for some time, came up with a total second best for this year, and surpassed in 1952 only by the spring months of April and May.

In summary, business activity is being well sustained by high levels of employment, incomes, retail trade, and construction, which in turn lend strength to the nondurable manufacturing industries. Government expenditures and business outlays for plant and equipment also continue at high levels.

Against the sustaining influences may be set the more conservative buying sentiment of businesses induced by the more plentiful supply of goods and by symptoms that some of the factors which have kept business operating under full steam may be losing their urgency. A good many people have felt for some time that the extreme high rates of activity might be subtracting something from the future.

The revised budget estimates, published last month, will need to be taken into account in business calculations. The projected cutback of \$2½ billion in federal expenditures during the current fiscal year ending next June 30, with reduction of the deficit from \$9.4 billion last year to \$3.8 billion (and practical balancing of the budget on a "cash" basis, including government trust fund receipts), means a lessening of inflationary pressures on the economy.

On the other hand, business will be aided by expiration of the excess profits tax on December 31, and individuals will have a reduction in personal income taxes at the same time. This still does not take account of further reduction in corporate taxes and reduction in excise taxes next year if the cuts scheduled for April under present law are permitted to go into effect.

A "Turning Point" in U.S. Budget

What Secretary of the Treasury Humphrey described as a "turning point" in our federal finances was indicated by the revised budget estimates for the fiscal year 1954 made public last month. Government expenditures, after rising steadily since 1948 – even before Korea – will for the first time be less than the year before. Also for the first time since 1948 new spending authority is substantially less than the estimated budget expenditures – indicating a declining rate of spending in later years.

The revised budget figures reveal that government economies have whittled the prospective '54 deficit to \$3.8 billion. This figure represents a reduction of more than \$6 billion from the \$9.9 billion deficit forecast last January, and of almost \$3 billion from the \$6.6 billion re-estimate made by President Eisenhower in May. Expenditures are now set at \$72.1 billion, or \$6.5 billion below the January estimate. The revenue estimate of \$68.3 billion takes account of the expiration of the excess profits tax and of temporary increases in individual income taxes on December 31, 1953 as well as expiration of temporary increases in excise taxes on March 31, 1954 as provided in existing law. This total is \$400 million below the January forecast but nevertheless exceeds all previous revenue records.

A reduction in the regular corporate tax rate of 5 percentage points is scheduled to take place on April 1, 1954. This expiration would not affect receipts in the fiscal year 1954. The estimated annual loss of revenue resulting from all these tax reductions is \$8 billion, the full effect of which would be reflected in the fiscal year 1955. It will be recalled that the President last May asked Congress for repeal of the scheduled reductions on April 1, 1954 in the regular corporation income tax and in excise taxes, pending further study of the whole tax structure.

The following table compares the latest estimates with those made in January and May as well as with the actual results in fiscal 1953:

(In Billions of Dollars)

	Fiscal 1953	Fiscal 1954		
	Actual	Jan. Est.	May Est.	Aug. Est.
Expenditures	\$ 74.6	\$ 78.6	\$ 74.1	\$ 72.1
Receipts	65.2	68.7	67.5	68.3
Surplus (+) or deficit (—)	\$—9.4	\$—9.9	\$—6.6	\$—3.8

About \$1 billion of the reduction in estimated expenditures since the May estimate was accounted for, Secretary Humphrey explained, by the end of the Korean war. The balance reflects the Administration's economy drive – carried forward by the determined and painstaking search for savings on the part of the Budget Bureau and the Appropriations Committees of Congress headed by Representative Taber and Senator Bridges and aided by their staff experts and advisers drafted from private industry, together with widespread cooperation on the part of government departments.

The budget cuts announced thus far do not reflect any further action under the President's recent directive on budget policy "progressively to reduce expenditures during the fiscal year 1954."

One consequence of the reduction in the deficit is a marked drop in the need for new Treasury demands on the money market in coming months. The revised deficit of \$3.8 billion would be approximately the same amount as the estimated issuance of government securities directly to the social security and other trust funds for the investment of their trust receipts. If such estimates should prove correct, they would mean that for the '54 fiscal year as a whole there would be no net demand for new funds from the outside money market, even though there are temporary demands for borrowing because of present tax provisions that concentrate income tax collections in the January and March quarters.

Treasury Financing

The lower than expected level of government outlays has slowed the drain on the \$5.9 billion borrowed by the Treasury July 15 on tax anticipation certificates and evidently has postponed until the fourth quarter the need for further borrowings. Meanwhile, maturities are requiring attention in rapid-fire sequence.

After the close of trading August 28 the Treasury announced its plans for handling the \$8 billion 2 per cent Treasury bonds due September 15. The holders of these bonds, originally sold in the Third War Loan drive, are given a two-way choice of converting them into one-year 2⅝ per cent certificates due September 15, 1954 or 2⅞ per cent three and one-half year Treasury notes due March 15, 1957. The announcement was favorably received in the market and premiums of ⅛ point or better were offered for the maturing bonds.

The one-year certificate, carrying the same 2⅝ per cent rate used on refundings in June and August, is designed to attract exchanges by holders interested in maintaining liquidity and minimizing risk of market price fluctuation. The ¼ per cent higher rate on the alternative offer of March, 1957 notes is a cost the Treasury is willing to incur to relieve the weight of refundings

looming up for 1954 and to space out some of the public debt maturities. The year 1957 at present is comparatively barren of maturities.

Money Market Improved

The Treasury earlier in the month had carried through its second offering of 2⅝ per cent one-year certificates of indebtedness, this one in exchange for certificates falling due August 15. The greatly improved tone of the money market since June is measured in the receptions afforded the successive 2⅝ per cent certificate issues: the June 1 offering obtained no better than an 85.4 per cent exchange; the August 15 offering produced a 96.7 per cent result.

The bond market had a more confident feel to it during August, a reflection of the easier situation of the banks following the July reductions in bank reserve requirements and a let-up in the volume of new bond offerings. Yields on high grade corporate and municipal bonds eased back ⅛ to ¼ per cent from the levels of May and June. The thirty-year 3¼ per cent Treasury bonds issued May 1, which on June 2 had dropped as low as 98½, reached 100½.

Despite the beginnings of autumn loan expansion, and Treasury drafts on proceeds of the tax anticipation certificates sold in July, the banks found it possible to hold their borrowings from the Federal Reserve within a daily average of $700 million as compared with a figure of $1,059 million in August, 1952. Short-term government securities were in good demand from corporations and also from foreign accounts. Banks thus found it easy to adjust their reserve positions by selling Treasury bills and tax anticipation certificates. The Federal Reserve Banks, which had dropped out of the government security market early in July when the reserve requirement reductions became effective, bought Treasury bills in moderate amounts during the second half of August. In the background of these developments the fears of a serious credit shortage this fall — so common in May — dissipated.

Spring Money Pinch Debated

Despite the easing of Federal Reserve credit policy in June and July, there have been further criticisms of credit policies and Treasury debt management. On the floors of Congress, and in some trade union publications, the money pinch of April and May has been pictured as a conspiracy of bankers to get higher rates. Such critics neglect to note that the episode had made bankers — who were in the direct line of fire — about as uncomfortable as anybody.

Lending in the United States is a highly competitive business. Money rates do not rise unless there is a scarcity of loan funds relative to demands. The restrictive credit policy pursued by the Federal Reserve tended, true enough, to raise interest rates received by banks. It also tended to shrink bank deposit volumes, to force banks to sell government securities on a falling market, and to bring a competitive rise in rates paid by banks on time deposits.

Federal Reserve reports on profits of its 6,800 member banks belie the accusations of any "gift" to the banks: they indicate a net increase of 5 per cent in the first half year. All corporations are estimated to have experienced an 8 per cent improvement in the same period; leading industrial corporations 17 per cent. It is also worthy of note that interest paid by banks to depositors exceeds dividends paid to shareholders. The benefits of more reasonable rates of interest fan out and encompass all who attempt — by saving, buying life insurance, and contributing to pension funds — to make provident preparation for the future. In the United States this covers almost everybody.

Senator Douglas' Criticisms

Senator Paul H. Douglas of Illinois joined the critics at the close of the Congressional session through a public statement. This came as a considerable surprise since Senator Douglas had been one of the staunchest and most outspoken advocates of flexible money rates and credit policy during the battle over bond price pegging two years ago.

In his statement, issued August 3, Senator Douglas excluded any impeachments of motive on the part of the responsible authorities. He approved the rise in government bond interest rates from their very low pegged levels of March 1951, to help reduce "the flooding of the money supply", but also commended the Federal Reserve's subsequent purchases of government securities which slowed the rise in money rates, and permitted increases — within desirable limits — in bank reserves, bank lending, bank deposits, and the money supply:

> From March 1951 to December 1952, we had virtually full employment, expanding production, and relatively stable general prices. We did not need a dose of inflation in order to get full utilization of our productive facilities and labor power.

This halcyon period, which Senator Douglas credits to the wisdom of Federal Reserve policy during the last twenty-two months of the previous Administration, was marred only by the steel strike adversely affecting production in the sum-

mer of 1952 and an edging advance of the cost of living index to a new peak in August, 1952. Wholesale prices worked lower, reflecting a drop in farm prices and cheapening raw material imports. Production and price movements since 1951 are shown in chart form on a following page.

As Senator Douglas interprets the course of events this year, the Federal Reserve Board, observing the new Administration's concern over the possibility of renewed inflation, "soon ceased to buy any government bonds at all." The result, he states, was that bank reserve balances fell by $1.4 billion or nearly 7 per cent between December and May. The money supply (defined as checking account deposits and currency outside banks) was cut from $129 billion in late December to $124.5 billion in late May, a decrease of 3.5 per cent. He continued:

> With a shortage of credit relative to the demands of industry at given price levels, it was inevitable that the interest rate should have been forced upward. But I seriously doubt whether it was necessary to increase the interest rate by one-half per cent, as the Treasury did. They moved, in my judgment, too fast and too far.
>
> The results have not been happy. The Federal Reserve in late May tried to reverse its policy and that of the Treasury by buying government bonds when they had fallen 11 points below par and also by reducing reserve requirements.

There are numerous observers of the economic scene, many within the financial community, who in the spring had shared the misgivings Senator Douglas expresses, that the rise in money rates was going too fast, and who were worried by the resultant build-up of fear and tension in the money and capital markets.

On the other hand, the Senator's recital of facts is misleading in a number of respects. For example, about half of the decline below par in government bonds had occurred before the new Administration took office. Moreover, on the record, the 3¼ per cent offered by the Treasury on thirty-year bonds was the absolute minimum at which any long-term money could be raised.

A Far-Fetched Implication

Certainly it seems far-fetched to imply, as Senator Douglas does, that the credit squeeze was a Treasury action: that the Treasury was "operating" the Federal Reserve and actually prodding the latter to adopt policies to undermine the market for Treasury securities. It is true that the Administration brought no effective pressure to bear on the Federal Reserve to support the prices of the bonds it had sold. It was precisely this sort of pressure that brought the Treasury under such severe criticism — from Senator Douglas among others — in 1950 and 1951.

Apart from these details, Senator Douglas centers his criticism on the point that the money supply decreased in the first five months of the year; in his appraisal of the economic situation, it should have increased. The easing of Federal Reserve policy in June, he states:

> . . . was done so the banks would have more credit with which to buy government bonds during the year and also to counteract the deflationary effects of their earlier policies.
>
> But a good deal of the damage had already been done and many of the economic tendencies which were set in motion are irreversible . . .
>
> What we need is sanity and a banking policy which will permit the money supply to grow approximately at the same rate as the index of production so that prices may be kept relatively stable and full employment effected.

Since people are free to decide how quickly they will spend their money, and since credit gives elasticity to the money supply, production and money supply have never held any firm and unchangeable relationship. Thus, while a slowly growing money supply may be consistent with relatively stable prices and full employment of a growing labor force, it does not insure the result. However, almost everyone agrees on the merits of the general objectives Senator Douglas holds in view.

Mr. Eccles' Views

With his statement Senator Douglas released a critical analysis of credit and debt management policies prepared by Marriner S. Eccles at the former's request. Mr. Eccles, now chairman of the First Security Corporation of Salt Lake City, a bank holding corporation, was a member of the Federal Reserve Board over the period 1934-51 and chairman from 1934-48. Mr. Eccles, who felt that inflation had run its course when the new Administration took office and that the prospect was deflation, finds little if anything that the Treasury and Federal Reserve have done right. Stressing the need for growth in the supply of money to keep prices from falling, he criticizes as "unjustified" the "extremely tight and hard" money policy adopted by the Federal Reserve System and Treasury.

Mr. Eccles in his analysis does not spare previous Administrations. He ranges back to the injustices of the great depression of the 1930's and the "entirely inadequate" government spending and deficit-financing programs designed to restore prosperity. He is critical of the Treasury's

failure to sell more bonds outside the banks during the war and earlier postwar periods and of the policy of pegging government security prices at par or better. It is to Mr. Eccles' everlasting credit that in 1951 he became an outspoken opponent of the inflationary bond price pegs. But some of his own ideas for wartime Treasury finance could have involved even greater inflationary hazards. When the United States entered the war he advised the Treasury to offer more obligations cashable at the option of the holder at the Treasury, and urged the Congress to suspend statutory restrictions on Treasury direct borrowing from the Federal Reserve Banks. This combination would have made price-pegging in effect a contractual obligation of the Treasury supported by direct Treasury access to the Federal Reserve's powers of money issue. Inflationary as the Federal Reserve's price-pegging was, the practice at least could be ended without violation of any contract.

Mr. Eccles is critical of the Federal Reserve for failing to manage the government security market "in such a manner as to assure continued success of Treasury financing." He characterizes the Treasury's offering of the thirty-year 3¼ per cent bonds as "a major blunder in debt management policy", for the reasons among others that deflation was the real danger, that it was floated at a time when banks were "being forced to sell billions of government securities", and that the Treasury will be able to borrow more cheaply when the authorities come to give up the idea of free markets. He would have had the Treasury do all its borrowing on Treasury bills, the most inflationary type of borrowing the Treasury can conduct inasmuch as Treasury bills are of such short term and involve such limited risk of price fluctuation that they are regarded by their holders as the practical equivalent of cash.

Secretary Humphrey's Statement

Referring to Congressional criticisms, Secretary of the Treasury George M. Humphrey, speaking in Seattle on August 3, denied that the Administration has, or ever has had, a "hard money" policy in the sense of "hard-to-get money and hard times":

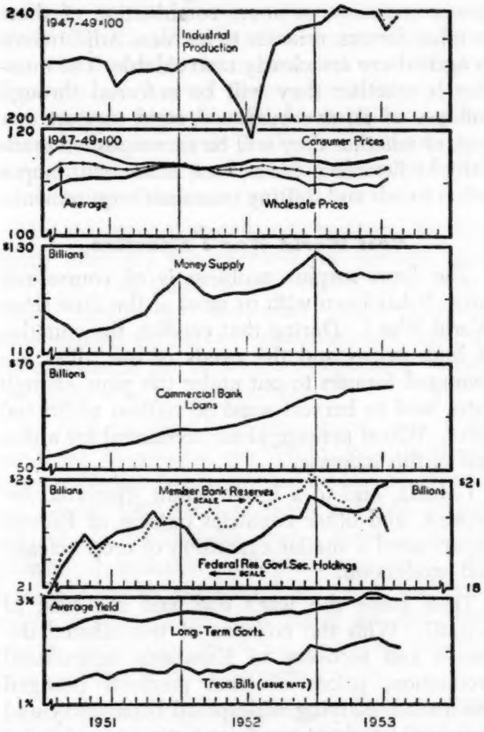
> Instead of hard money the goal of this Administration is honest money. By "honest money" we mean money that will buy as much next week, next month and next year as it will buy today. If by better handling of the Government's financial matters, this Administration can provide more honest money it will be a great service for the laborer, the office worker, the pensioner — in fact for every citizen. Americans by tradition expect honesty in all things. This Administration is determined to put an end to further decline in the value of our money and provide again an honest dollar.
>
> The Federal Reserve System has the main responsibility for monetary policy in this Government. This System is non-partisan, and since the accord with the Treasury in 1951, the Federal Reserve System has been helping to promote an honest dollar by not artificially enlarging the supply of money for the purpose of keeping the interest rates on Government issues low. The new Administration has confirmed this policy and assured the Federal Reserve System that it will have the prime responsibility for maintaining the money and credit situation free of artificial restraints in the best interests of all Americans.
>
> The Federal Reserve has no hard money policy. It has simply allowed the demand for money to have its normal and natural effect and respond to the law of supply and demand. It has supplied additional funds to keep pace with normal growth.
>
> The Treasury's main role in this business of keeping honest money lies in its handling of the public debt. That debt is now over $272 billion, and the manner in which refinancing and the placement of new issues is handled can affect the entire nation's well-being. The Treasury is trying to make the debt sounder by gradually extending the length of its maturities. Now nearly three-quarters of the debt matures within less than five years.
>
> In April we took a first step in trying to convert some of this into sounder and less inflationary issues by putting out a 30-year bond at an interest rate of 3¼ per cent. That rate was higher than the coupon rate for previous issues but it reflected the going rate at the time of issue as fixed by the current daily market purchases and sales at the time the bonds were sold. Gradually and at opportune times further long-term issues will be sold, but care will always be exercised not to press the market unduly in competition with other state, municipal and private financing.

The Alleged Deflation of Money

In their appraisal of the financial record Senator Douglas and Mr. Eccles exaggerate their case by omitting reference to the seasonal peaks each Christmas in demands for money and credit which are reflected in increased Federal Reserve holdings of government securities, member bank reserve balances, and money supply. In January and February the money market is characteristically eased, and there are reverse movements in Federal Reserve holdings of government securities, bank reserves, and money supply. For example, a decline in money supply during the first five months of 1953, of which Senator Douglas and Mr. Eccles are so critical, is a usual affair. In 1951 and 1952 the first five months produced declines of $3¼ billion. It is true that the $4½ billion decline this year was larger; nevertheless, the money supply at the close of May was $3.2 billion above May 1952 and the highest for any May on record.

As for Federal Reserve holdings of government securities, the post-Christmas reduction this year was actually *less* than in 1952, though this did not mean a relaxed policy. Gold was flowing out, instead of in as in 1952, and banks were having to borrow considerable amounts

from the Federal Reserve, and at an advanced discount rate, to maintain their required cash reserves. The money market stringency of April and May developed as the Federal Reserve pressed banks to cut down their borrowings at a time when credit demands were exceptionally strong. The decline in bank reserve balances in the January-May period, strongly influenced by the gold outflow and repayments of borrowings from the Federal Reserve by the banks, *was* of abnormally large proportions.



Industrial Production, Wholesale and Consumer Prices, Money Supply (currency outside banks and adjusted demand deposits), Commercial Bank Loans, Daily Average Federal Reserve Holdings of Government Securities, Daily Average Member Bank Reserves, Daily Average Yield on Long-Term Government Bonds, and Average Yield on New Issues of Treasury Bills.

Sources: Federal Reserve Board; U.S. Department of Commerce; U.S. Bureau of Labor Statistics; U.S. Treasury Dept.

In May the Federal Reserve began to buy government securities on a small scale and increased these purchases in June. On June 24 this easing of policy was dramatically emphasized when the Federal Reserve freed, effective in July, $1 billion from bank cash tied up in satisfaction of legal reserve requirements. Bank borrowings were reduced and fears of criticism for borrowing too often were lessened.

The Economic Record

In light of all this controversy it is relevant to take a look at the economic conditions during the spring when the Federal Reserve and Treasury were having to make their decisions. Production was running higher than a year before, as the chart shows, and requiring overtime work in many of the industries. With the benefit of a restrictive credit policy, broad price indexes held steady – a fact that is of special significance in light of the removal of price and wage controls during February and March. The reasonable conclusion would seem to be that pressure on credit supply this spring – spreading caution among lenders and borrowers alike – might have had a healthy effect of avoiding another rash of advancing prices.

The performance of the economy suggests that Senator Douglas' description of 1951-52, cited earlier, also fits the first half of 1953: "we did not need a dose of inflation to get full utilization of our productive facilities and labor power."

Even now, three months after the worst of the credit squeeze, there are no signs of broad credit or price deflation. Industrial production declined seasonally in July but continued ahead of 1951 and 1952, and nonagricultural employment reached the highest level for the month on record. Since June the price movement has been upward, rather than the reverse, and fractional advances in the cost of living index to a new high level have brought into play escalation clauses under wage contracts.

If business should decline sharply later this year some people may be inclined to put the blame on the April-May credit squeeze on the theory that the June-July ease-up did not come quickly enough. Senator Douglas, as noted earlier, feels that "many of the economic tendencies which were set in motion are irreversible." If this view should prove to be correct, it will also have to be admitted that, probably for the first time in history, the authorities eased up to relieve a business downturn months before it had confirmed its existence in the broad employment, production and price indexes.

Risks in Prophecy

There is one significant cleavage in the views of Senator Douglas and Mr. Eccles. Senator Douglas implicitly agrees with the authorities that there were risks of inflation and needs for broad restraint on credit this spring. Mr. Eccles, while favoring specific curbs on mortgage and consumer credit, places the burden of criticism on his forecast of deflation ahead. Warnings of deflation ahead have been handed out from various quarters year after year since the end of the war. Only once – in 1949 – were such forecasts correct. It is impossible to calculate how little

the dollar would be worth today if public policy had been geared to the idea that a prospect of eventual deflation excluded any need for concern over inflationary trends. The authorities must play by ear, on the basis of observed developments and trends. They cannot be diverted by forecasts that are as likely to be wrong as right.

As Dr. Arthur F. Burns, the new chairman of the President's Council of Economic Advisers, once observed: "The gift of prophecy has never loomed large in the endowment of economists, whether lay or professional."

Prospects for Agriculture

Recent issues of this Letter have touched upon the policy of high and rigid farm price supports inherited by the Eisenhower Administration, and the difficulties and contradictions into which the policy has led. It was shown that the fall in agricultural prices has been cushioned at the cost of accumulating huge stocks of farm products either owned outright by the Government or held under government loan. At the same time the high support prices are leading both to import curbs against competing farm products from abroad, in conflict with the Administration's avowed desire to promote "trade, not aid," and to regimentation of farmers through production and marketing controls.

More and more, people are wondering how long the Government can go on supporting farm products in the face of mounting surpluses.

The latest report of the Commodity Credit Corporation showed as of May 31 a $3.2 billion investment in price support programs, more than double that of a year earlier. With another large crop being harvested and with prices of many farm products well below support levels, a further large increase in the total investment is indicated.

Congress, in the Agricultural Act of 1949, endeavored to forestall just such a situation by providing for restrictions on acreage and marketing of crops, as well as a system of flexible price supports. But there has been notable reluctance on the part of both Congress and the farmers to allow these provisions to go into effect. In July 1952 Congress extended the 90 per cent support rate on basic commodities through the 1953 and 1954 crop seasons, and only last July raised the minimum national wheat acreage allotment from 55 million to 62 million acres. Pressure was also exerted to ease curbs on other crops.

As surpluses of some crops become unmanageable, the Secretary of Agriculture, in the absence of adequate markets at home or abroad, has no alternative but to limit how much farmers can grow and sell — as required by law. This he has done for the 1954 wheat crop, and marketing quotas proclaimed on that crop were approved by 87 per cent of the producers who voted in a referendum held August 14.

Whether the surplus problem will be solved by government restrictions, such as now proclaimed for wheat, recovery of old markets, discovery of new outlets, the quirks of nature, a new emergency, or some combination of these or other factors, remains to be seen. Adjustments in agriculture are clearly unavoidable. The question is whether they will be enforced through collapse of an overburdened rigid support system, or whether they will be accomplished gradually by flexible policies more in line with population trends and shifting consumer requirements.

Post World War I Situation

The farm surplus problem is of course not new. It has been with us most of the time since World War I. During that conflict, the stimulus of high prices and the needs of our allies encouraged farmers to put under the plow enough extra land to harvest some 36 million additional acres. Wheat acreage alone accounted for about half of this increase.

Canada, and to a lesser extent Australia, Argentina, and other countries outside of Europe experienced a similar expansion of crop acreage and production.

Then came the war's end and the bust of 1920-21. With the collapse of war-inflated demands and recovery of European agricultural production, prices of farm products plunged downward, carrying widespread bankruptcy and distress throughout our farm regions.

Though farm prices recovered from the low levels of 1921, agriculture continued to suffer from the hangover of the boom, with its legacy of overexpansion and burdensome debt. Competition in world markets increased, due both to the recovery in European output and to the opening up of new producing areas in Canada, Australia, and Argentina. American exports of farm products, which had reached a peak of $4.1 billion in 1919 were down by 1930 to $1.2 billion.

Other factors tending to depress prices were the growth of synthetics of nonfarm origin to replace textile fibers and leather, and revolutionary changes occurring in American agriculture itself. As to the latter, the rapid substitution on farms of tractors, machinery, and electricity for horses, mules, and hand labor increased the ef-

ficiency of production and enabled farmers to combat unfavorable weather conditions more easily, further adding to food supplies and depressing prices. Moreover, the decline in horse and mule numbers from 26.7 million in 1918 to 14.4 million in 1940 released some 60 million acres of land formerly required for growing feed. This land, along with the additional land placed under the plow during World War I, further added to the land available for food production.

Research and education also had a share in pushing up production, particularly during World War II. The adoption of new techniques was stimulated by rising farm prices and labor shortages. New crop varieties and disease and pest controls were introduced, fertilizer use increased, and livestock production methods improved; the shift to hybrid seed corn raised yields by one-third.

The change in dietary habits has been another factor affecting the demand for certain farm products. The trend to more fruits, green vegetables, meat, eggs, and dairy products, while beneficial to agriculture generally, has been at the expense of per capita consumption of wheat, rye, other cereals, and potatoes.

By 1946 the total farm output was more than one-third above the pre-World War II level. During the last few years the rise has continued, our record 1952 farm production being 45 per cent above the 1935-39 level. Demands of our growing population and maintenance of our farm exports by generous loans, gifts, and subsidies, kept surpluses from piling up. But with exports down sharply in the past year, the surplus problem is again becoming acute.

Only the outbreak of fighting in Korea in 1950 delayed our having to face up to the problem before. Our agriculture support program was then already in deep water, as government inventories of farm products piled up and threatened to exhaust the borrowing power of the Commodity Credit Corporation. In that instance the Government was bailed out by world buying induced by the onset of hostilities.

Post World War II Food Production

The unhappy experience of American agriculture after World War I has inevitably colored the thinking of the farmer who, during the new boom induced by World War II, has been haunted by fear of another postwar collapse. The general public, associating the business depression of 1921 with the agricultural price breaks of 1920-21, has also been apprehensive.

Actually the situation of agriculture after World War II differs in important aspects from that after World War I.

In the first place, there has been no such widespread and rapid expansion of acreage and production as in the earlier period. Only in North America has there been any significant increase in production, and in the United States the great expansion that took place was primarily the result of changes in yield per acre rather than in crop area. The failure of output elsewhere to expand is illustrated by the following figures comparing world production of breadgrain by major areas in 1952 with the 1935-39 average:

World Production of Breadgrain

(In Thousands of Short Tons)

	1935-39	1952
North America	34,090	61,090
Europe	69,420	68,540
U.S.S.R.	61,980	61,430
Asia	45,360	49,300
Africa	4,320	5,220
South America	8,735	11,650
Oceania	5,310	5,100
World Total	229,215	262,330

Source: U. S. Department of Agriculture report on "World Food Situation 1953" released in February 1953.

The lag in world food production reflects civil and military disturbances as in the "rice bowl" countries of Southeast Asia, insecurity of land tenure, inadequacy of returns, and lack of investment capital and credit. It reflects also a general emphasis placed on industrialization in primary producing countries which tended to slow down rural development and to reduce surpluses of such traditional food exporters as Australia and Argentina.

World Population and Food Supply

The second distinguishing feature of the post World War II food situation is the great increase in world population due to higher birth rates and lower death rates.

Eight years after the war the average food supply per person over large areas of the world was still lower than before the war. Moreover, according to Norris E. Dodd, Director-General of the Food and Agriculture Organization of the United Nations, the situation is not improving. Writing in the preface to the "Second World Food Survey" by that organization in November 1952, he said:

> Clear signs of any far-reaching changes in the entire scale of food production, essential for the improvement of nutrition on a wide scale, are lacking. Annual increases in food production are barely keeping pace with the increasing population. The intensification of health measures in under-developed countries, in particular the use of new methods for controlling mass diseases such as malaria, is likely to lead to still more rapid growth in numbers.

As shown by the following table giving world food production on a per capita basis by major areas, only North America has recorded any important increase since prewar. The showing for the Near East is bolstered by Turkey, which, with the aid of American mechanized equipment and know-how, has nearly doubled its agricultural output in the past five years.

World Farm and Food Production in 1951-52

(1934-38 = 100)

	Total Farm Production	Food Production	Population	Per Capita Food Output
North America	141	144	121	119
Latin America	115	116	136	85
Europe (ex. USSR)	101	100	111	90
Near East	124	123	121	102
Far East	101	100	118	86
Africa	122	118	120	98
Oceania	111	110	124	89
World (ex. USSR)	111	111	118	93

Based on data in "The State of Food and Agriculture: Review and Outlook, 1952" prepared by the Food and Agriculture Organization of the United Nations, October 1952.

With this widespread lag in food output, the Free World has been fortunate in having these North American surpluses to fall back on. Without them – a considerable proportion of which has been given away in foreign aid – the standard of living in many countries of Western Europe and Asia would have fallen much lower, particularly in the early postwar years.

Outlook for Exports

The world picture is therefore not one of overproduction but of maldistribution and underconsumption. In these circumstances, the quick answer to this country's farm surplus problem would seem to be more exports.

Unfortunately, any plan to increase farm exports by other than partial or outright giveaway programs, which are now tapering off, runs into practical difficulties.

First, there is the old problem of other countries' not having the necessary dollars. The farmer, as well as other exporters, is witnessing a demonstration of his stake in a balanced give-and-take in international trade.

Second, our high price supports make American farm products too expensive for foreigners to buy with their scarce dollars.

Third, with agriculture recuperating and slowly expanding the world over, other countries are becoming less dependent upon our surpluses. Due to balance of payments difficulties, many countries are intensifying their efforts to develop their own agricultural resources. At the same time the political power of farmers, strong everywhere, is again being exerted to shelter the home growers against foreign competition.

While the exportability of our farm products in the future will continue to depend to a degree upon our prices, the ability of foreign countries to earn dollars, and the amount of our foreign aid, it is clear that the United States cannot expect to solve its problem of agricultural surpluses by dumping them abroad. Already foreign countries are showing a growing sensitivity on this point. Thus the recent gift of wheat by this country to Pakistan, and President Eisenhower's request that he be granted authority to give away food to relieve world famine, have aroused fears abroad of dumping by this country under guise of relief. Talk here of a two-price system for wheat in which the surplus above domestic needs would be offered on the world markets at prevailing prices, is regarded as even more disturbing.

The Domestic Market

Since exports, despite their importance to the American farmer, cannot be counted on to solve his surplus problem, it follows that he must look primarily to his main market at home. Here the prospects for enlarged demand, revealed in projections by the Department of Agriculture, verge on the sensational. Statements by Dr. Byron T. Shaw, head of the Agricultural Research Administration, before the National Farm Chemurgic Council last March, are an example.

The present abundance of food, Dr. Shaw declared, is only temporary.

The nation, he pointed out, is now growing at the rate of about 2½ million persons a year. By 1975 the population experts say there will probably be 190,000,000 Americans, even if the present birth rate declines. If U.S. farmers are going to feed them they will have to produce almost one-third more food than at present to keep living standards from falling, he said.

On the basis of 1950 yields per acre and rates of consumption of food and fiber, that would require over 100 million more acres of cropland. But Dr. Shaw estimated this probably would be around 70 million more acres than farmers can economically bring into use, because nearly all the good croplands now are farmed.

The obvious solution, as Dr. Shaw said, is to make the available acres produce as much more as 70 million additional acres could. And that, he indicated, is a job for science.

The question of how much productivity can be increased is one on which experts differ. As Dr. Shaw sees it, the U.S. is using up scientific information faster than we are producing it. The science cupboard is getting bare. We shall have to push harder on the research front if we are

going to meet national needs. Others take a more optimistic view of the production potentials.

Certainly no one believes that scientific advance in agriculture has come to an end. But that American farming is on the threshold of any such revolutionary upsurge in productivity as occurred during the past three decades remains to be demonstrated.

Meantime, over the short run, farmers face the test of a declining market. "Reports and predictions," stated Under Secretary of Agriculture True D. Morse early this year, "confirm the fact that easy money in farming is past. The squeeze on farm profits is tightening."

Mr. Morse expressed concern that "well over one-half of those now charged with the management of businesses and farms have never experienced other than a rather continuous uptrend in prices." And, as he went on to observe, "The true test of management comes when prices and incomes are declining."

Problem of Farm Policy

All this has given new urgency to discussion of government farm policy.

Few people question the principle of placing "floors" at some point under agricultural prices to cushion extreme declines. No one wants to see a repetition of 1932 when the general industrial depression and collapse of values produced conditions with which farmers were unable to cope. But there is widespread disapproval of the tendency to push farm price supports higher and higher, and dissent from the thesis that agriculture is entitled to special protection from normal market risks. Secretary of Agriculture Ezra T. Benson put the case well when he said in the April 1953 Farm Journal: "I don't believe that supports should be so high as to subsidize the inefficient. We can't guarantee a profit to every farmer, any more than we can to every retailer."

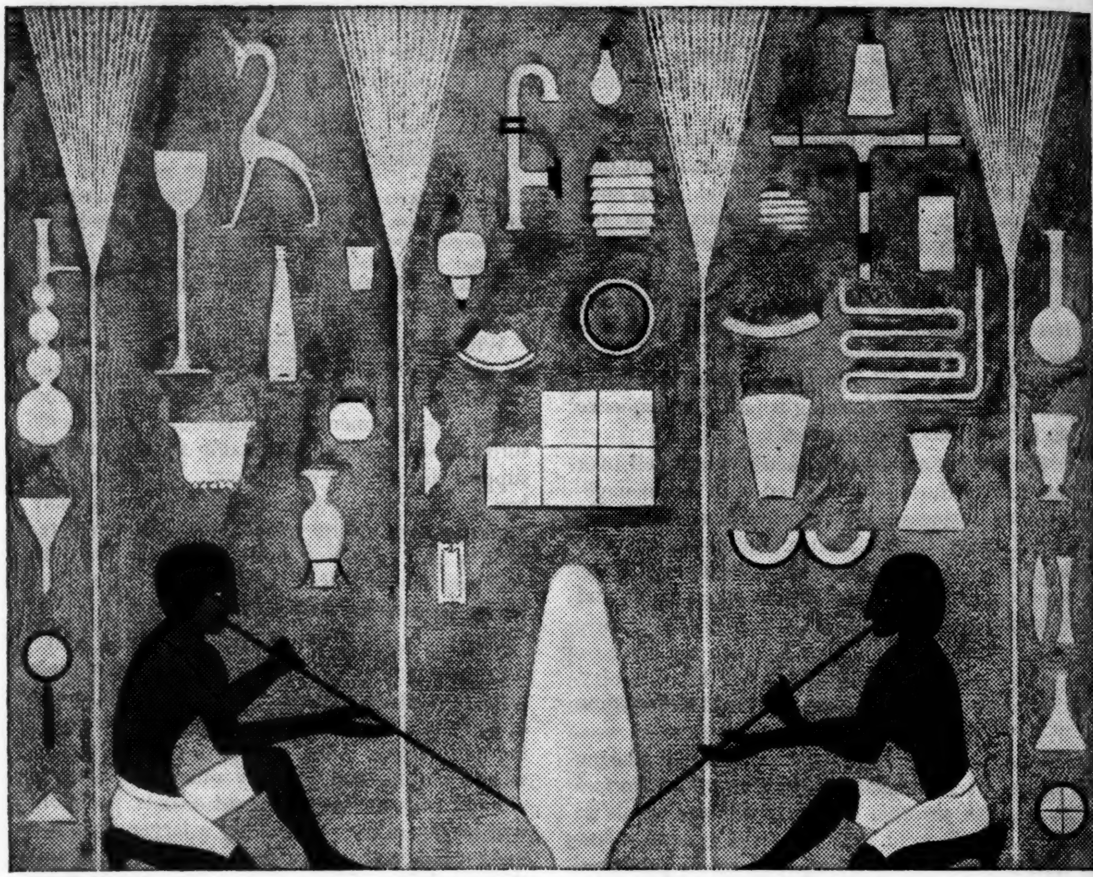
Moreover, supports fixed at too high a level invite other difficulties. They can kick back on the farmer by pricing a commodity out of its market, as witness the case of butter. They carry danger of collapse under the piling up of government holdings of farm products. The controls and restrictions which are inescapable under high and rigid price supports limit individual opportunity and penalize efficiency. If the farm program is to be flexible, as it has to be to meet changing conditions, it must return to the flexible support principles written into the law of 1949, but never given a chance to operate. To quote Secretary Benson again:

> Price supports not only must provide basic stability for agriculture; they should also contain incentives for progress by encouraging production shifts toward balanced supply in terms of demand, by encouraging economic production, and by avoiding excessive surpluses and subsidies.

While a return to flexible price supports would be a step in the right direction no one supposes this alone is the answer. Nor is the imposition of acreage allotments and marketing quotas any sure cure for surplus production so long as high support prices are maintained. As experience has shown, farmers facing such restrictions may intensify their efforts to increase yield per acre, thus in part offsetting the restrictions. Or they may use the land for non-restricted crops, thus tending to develop surpluses elsewhere.

What is needed is a policy that would make it to the advantage of farmers to reorganize their farm businesses to provide the additional meat, milk, eggs, and vegetables required by our growing population. Curtailment of the output of wheat, cotton, and possibly other products, in view of present limited export outlets, probably will be necessary. Eventually a larger domestic market for these products is also in prospect, and the possibility of some future recovery in their export should not be dismissed entirely. But in the meantime satisfying the wants and preferences of our own people will, if realized, be a tremendous agricultural achievement.

Congress is now holding hearings in various parts of the country to obtain "grass roots" opinions from farmers and their leaders as to future farm policies. The information so collected, plus the assistance to be provided by President Eisenhower's 18-man bipartisan National Agricultural Advisory Commission and the various commodity advisory committees of the Department of Agriculture, should be helpful in working out a sound and practicable program. In the final analysis, a national policy which promotes a high level of employment, production, and purchasing power, with maximum consumption of farm products, will be found to be the best policy for agriculture.



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